

**MINUTES**

**MONTANA SENATE  
56th LEGISLATURE - REGULAR SESSION  
COMMITTEE ON BUSINESS AND INDUSTRY**

**Call to Order:** By **CHAIRMAN JOHN HERTEL**, on January 27, 1999 at 9:00 A.M., in Room 410 Capitol.

**ROLL CALL**

**Members Present:**

Sen. John Hertel, Chairman (R)  
Sen. Mike Sprague, Vice Chairman (R)  
Sen. Dale Berry (R)  
Sen. Vicki Cocchiarella (D)  
Sen. Bea McCarthy (D)  
Sen. Glenn Roush (D)  
Sen. Fred Thomas (R)

**Members Excused:** None.

**Members Absent:** None.

**Staff Present:** Bart Campbell, Legislative Branch  
Mary Gay Wells, Committee Secretary

**Please Note:** These are summary minutes. Testimony and discussion are paraphrased and condensed.

**Committee Business Summary:**

Hearing(s) & Date(s) Posted: SB 234, 1/22/1999;  
SB 240, 1/22/1999  
Executive Action: None

**{Tape : 1; Side : A; Approx. Time Counter : 0}**

**HEARING ON SB 234**

**Sponsor: SENATOR FRED THOMAS, SD 31, STEVENSVILLE**

**Proponents:** Mark Barry, Senior V-P, MT State Fund

**Opponents:** George Wood, Executive Secretary, MT Self Insurers' Assoc.

Jerry Driscoll, MT Building & Construction Trades Council.

**Opening Statement by Sponsor:**

**SENATOR FRED THOMAS, SD 31, STEVENSVILLE.** This bill was requested by the State Fund. This legislation would allow the State Fund to provide insurance related services for the Montana Employers for Workers Compensation needs--not just insurance policies but other services. This would be a natural extension of the Workers Compensation services already provided by the State Fund. It will enhance their overall services to our customers of the State Fund by allowing the Fund to operate more like a full service Workers Compensation provider. At this point, they are only allowed to sell a first party coverage policy. The new services allowed would be loss control, an accident prevention service, early return to work programs, the fraud prevention, the claims management, etc. It is well within the thought process that we should have this and that they should be able to do this at this time.

There are insurance cycles that they go through and right now we are in a better cycle for premiums that are headed downward. Claims activity has been fairly good. Part of the reason the claims are going down is claims management is much better in the Fund and the private sector is doing a super job. This is saving a lot of money for employers and employees. The cycles are there and we need to go up and go down with the cycles. When the cycles are giving them a hard time on premiums they need to be able to say that if you, the client, do not want to be insured directly, they can do it on a pool arrangement.

There is going to be legislation before this committee that will be asking you to let the University of Montana buy their insurance from whom they want. This is a bill sponsored by **Rep. John Mercer**. Right now they can't. They are locked into the State Fund. So we feel that if it is good for one it will be good for both. We are asking you to let the market be the determination for the University System and in this bill we are asking to let the State Fund compete out there and be active in the whole Workers Compensation market.

**Proponents' Testimony:**

**Mark Barry, Senior V-P, MT State Fund.** He gave his testimony and handed in **EXHIBIT (bus21a01)**.

**Opponents' Testimony:**

**George Wood, Executive Secretary, MT Self Insurers' Assoc.** We rise in opposition to the bill. In spite of what Mr. Barry said, it is a case of philosophical differences. The services that would be allowed to the State Fund in this bill are presently provided by private businesses in Montana. There are no public agencies providing this type of business. It is private versus public. Those private enterprises are taxpaying enterprises: personal property, income taxes, real estate taxes, etc. This is not a pie in the sky market either. Most of the services that would be provided under this bill will be provided by my members. The purchasers of third party administration services are self insurers--self insured employers. The insurance companies provide their own. That is they have their own claims department, etc. But they are not unrestricted in what they can buy. If an employer decides to self insure, he goes to his agent and tells him he would like to try this self insurance. If he is large enough, the safety is there and if he has a sufficient premium, the agent may be able to look up a market for that. In that market, the re-insurer has a list, and by and large those that are allowed to provide these services, are approved. They are paid for by the employer but approved by the re-insurer. If the re-insurer happens to be an insurance company that writes private insurance, they may use their own claims department to do it and it isn't open. Most of this that isn't done by insurance companies is done by small, third party administrators in Montana. Some of our members use self administration--their own employees administer the Workers Compensation. A number of them that are multi-state operators are with insurance companies and use the insurance companies adjusting services. There are a number in the state who are with small private enterprises. There may be some bids on these things that would work to some advantage of our members if the State Fund were approved by the writer of re-insurance. This is not the first time this issue has been before the legislature. The State Fund has had it here before. The State wants this authority; they don't need it. I have not had one of my members say that there isn't sufficient third party administrative services out there to satisfy their needs--not one. For that reason, we suggest that you Do Not Pass.

**Jerry Driscoll, MT Building & Construction Trades Council.** I have watched the State Fund go broke twice. Every time they cut benefits to bail themselves out. Now they want to get involved in things that they should not be involved in because the private

industry is already doing it. In the 1980's we passed pooling and they have private people doing their administration. They all pay taxes. The State Fund does not pay the premium tax, the property tax or income tax. If they want to be a business and compete, then start taxing them or remove the taxes from the other people. Make it equal. Let's not get into a situation that Montana has been in before. I hope that you do not pass this bill.

**{Tape : 1; Side : A; Approx. Time Counter : 19.2}**

**Questions from Committee Members and Responses:**

**SENATOR VICKI COCCHIARELLA** asked **SEN. THOMAS** if this bill passes, would the State Fund be subject to the Fair Claims Practices Act and where would they get the money to pay if they lost a suit like that. **SEN. THOMAS** replied that they are not subject to the Insurance Commissioner at this time and that is who enforces that Act. He would not object to their being subject to that Act. The State Fund would have to be regulated like any other insurer.

**SEN. COCCHIARELLA** then asked if **SEN. THOMAS'** business is subject to the Fair Claims Practices Act. **SEN. THOMAS** said that anything he does is under all jurisdictions and acts.

**SENATOR MIKE SPRAGUE** asked **Mr. Wood** that if **HB 57** is passed, would that turn a want into a need. **Mr. Wood** said no. **SEN. SPRAGUE** asked **Mr. Barry** the same question. **Mr. Barry** answered that **HB57** is not much of a premium to them. The larger accounts are subsidizing the smaller accounts. They can operate with out it and so no, it is not a need.

**SEN. COCCHIARELLA** asked **SEN. THOMAS** why the effective date is on the day of passage and approval. **SEN. THOMAS** said the intent here was to get the State Fund quickly into the market as the market is a changing one. They could live with a later effective date. It would be helpful to get started as soon as possible.

**SEN. COCCHIARELLA** asked **Mr. Driscoll** if there is money given to the State Fund from the General Fund. **Mr. Driscoll** said that the General Fund gave the State Fund \$20 million in 1987, but they paid it back in the last session--1997. The payroll tax involved \$266 million to subsidize the Old Fund. The premium dollars that they put into the Old Fund was approximately \$160 million so about \$100 million, net tax dollars, went into the program. **SEN. COCCHIARELLA** then asked if **Mr. Driscoll's** basic objection to this bill is the fear that there could be a great loss again in the State Fund. **Mr. Driscoll** said that at present, the people running the State Fund are doing a good job, but who knows what

will happen when someone else takes over the job. Over the years they have cut benefits, taxed people, etc. to bail themselves out and he would not like to let them have that opportunity to get into a jam again. There is a place for the State Fund and that is as an insurer of last resort and if they do insure someone they should provide those services, but they shouldn't be competing in the private sector and getting all the special privileges.

**SENATOR JOHN HERTEL** asked **Mr. Driscoll** if he felt that by the implementation of this proposal, the State Fund would be put into more jeopardy and in turn possibly cause it to lose funds. **Mr. Driscoll** said that no one has a crystal ball, but it has happened before and he does not want any more benefit cuts.

**SEN. HERTEL** asked **SEN. THOMAS** the same question. **SEN. THOMAS** said that his proposal does not put the State Fund into jeopardy. The point is that the State Fund should be properly protected by the Board--the hiring of the President, etc. that insulates them from the political activity that was done in the 1980's.

**Closing by Sponsor:**

**SEN. THOMAS** closed. If you look at the second page of the bill, line 14, concerning Workmen's Compensation and line 15, stating what they would be allowed to do, this is what the bill is asking for. If you buy the arguments that the opponents bring up here, then you should eliminate the State Fund now. It should not exist. It is competing with the private sector. This bill wants them to be able to offer some services that are related to Worker's Compensation. The University System is an example. They say they don't want to buy from you any more, but we will consider your proposal to manage our claims. What would be wrong with the State Fund from doing that? This bill allows that to happen. Another example might be, a big California company comes into Montana and wants to sell worker's compensation coverage. They do not want to get into it too deeply, but they want to contract with the State Fund. What would be wrong with that? Another example of a trucking firm was given. The market share is shrinking and with that changing market we need to allow the State Fund to make some adjustments as well. They are doing a good job and this bill will let them change to the market that is changing and will allow them to be more competitive and stronger. We can make the Fund a bit more like a business. This makes Montana better and makes Montana more like a business. That is the direction we need to go.

*{Tape : 1; Side : A; Approx. Time Counter : 36.4}*

HEARING ON SB 240

Sponsor: SENATOR DUANE GRIMES, SD 20, CLANCY

Proponents: Mike Foster, MT Contractors' Assoc.  
Dick Anderson, Contractor, Helena  
Carl Schweitzer, American Subcontractors Assoc.  
of Montana  
Zack Pallister, American Subcontractors Assoc.  
of Montana, Big Sky Plumbing & Heating, Helena  
Joel Wolfe, Polar Electric  
Jim Wolfe, Polar Electric  
Robert Pierson, Pierson Painting  
Tim Crow, Big Sky Sprinklers & Landscaping  
Jenny Kalchbrenner, Merit Mechanical Services,  
Helena

Opponents: Jim Whaley, Chief, Design Bureau, Administration  
Tim Reardon, Chief Counsel, Legal Services  
Transportation

Opening Statement by Sponsor:

SENATOR DUANE GRIMES, SD 20, CLANCY. The bill that I have to present this morning, I will turn over to the proponents. The bill clarifies in statute who is entitled to the retainage and the interest. There are some proposed amendments and concerns. I am open to whatever the committee decides.

Proponents' Testimony:

Mike Foster, MT Contractors' Assoc. This bill is brought to you because there has been a problem at various levels of government where there has been some disagreement about who owns the interest on retainage. Sometimes, we have situations where governmental entities will try to keep the interest that should belong to the contractor. In many instances, at some levels of government, that interest is given to the contractor as it rightly should be. If we look at the statutes closely, the statutes do declare that the interest belongs to the contractor. Apparently, there has been some sort of disagreement or lack of communication or understanding. We decided to bring a bill that would clarify that the interest on retainage for construction projects truly does belong to the contractor. Yesterday, we were contacted by Tom O'Connell in the Department of Administration and he had legitimate concerns about the administration of this

bill as it is written. We explained that we are not trying to create work for any state or local level of government. We are willing to work with any agencies that have concerns about the administration of this bill. It could require some amendments to the bill. There has been language put forth that would amend it and we are looking at that now. Our initial reaction is that it is good. We are open to suggestion on how to make this work. I was handed considerable amendments just before the hearing from a group of subcontractors. We are willing to talk. We have **Dick Anderson**, a contractor from Helena, here willing to explain the situation as he understands it.

**Dick Anderson, General Contractor, Helena.** We are just trying to clarify the bill. When we talked to Tom O'Connell yesterday, he indicated that the way the bill was written it was going to create undue paper work for the state to keep track of the interest for each company. If the state would keep track they could divide the money among the subcontractors. If the state law stays like it is now, what it states is: "I have the right to put up a \$100,000 CD and I would receive the interest on the end of that and they won't retain from me". But I am not going to put my money up and then split it with someone else. There would have to be some way the state could actually put the money into an interest bearing account and at the end we could split it up. The retainage issue is a big problem. We have had excuses that people are on vacation so they weren't able to return our money. We have had checks held up to six months because they haven't had a chance to get to it. They have been too busy. The architect hasn't turned his work in, etc. etc. etc. The money just sits there and I assume they are earning the interest on my money. Our contracts are written with our subcontractors that when we receive our retainage, we pay them. So they are sitting there like we are. The subcontractors say that the general contractor will hold their money beyond that time also. It is a major problem and it would be great if we automatically got interest on it. We just need to clarify the issue.

**{Tape : 1; Side : B; Approx. Time Counter : 0}**

**Carl Schweitzer, American Subcontractors Association of MT.** We have some suggested amendments and would like to pass these out to you **EXHIBIT (bus21a02)** for your consideration. If this committee will accept the offered amendments, we are in support of this bill. Our amendments can be summed up by the old cliché: What is good for the goose is good for the gander.

When you look at an average construction project, between 80 to 90% of the work is done by subcontractors. Therefore, retainage for work done and the interest that is being earned should be

shared by subcontractors. In the bill itself, there is a definition of retainage. Retainage means an amount of money due a contractor and (we have added "or subcontractor") for construction services or materials, or both, that is withheld from payment to the contractor or subcontractor. That means they have done the work, a payment has been made, but a portion of that payment has been withheld until the whole project has been completed. This bill is divided into two parts.

Look at Section 1. it talks about governmental entities--work that is done on government projects. Look at Section 2. it actually looks like it is talking about work that is done for the private sector construction. Our amendments have been applied to both sections. In both sections we have added a subsection 2. In this subsection it states that the interest accrued in subsection 1 shall be for the benefit of both the general contractor and the subcontractors. We believe that when a subcontractor has retainage withheld, it should also be placed in an interest-bearing account for the benefit of the subcontractor. The new subsection 3 states that the contractor shall insure that the accrued interest is distributed to himself and the subcontractors on a prorata basis. When a payment is made and some retainage is withheld, it needs to be identified that a portion rightfully goes to the general contractor and payment is given from the owner to that general for the subcontractor's work and when that happens and retainage is withheld, at that point in time it should be identified so you know how much interest is going to be earned from that money. Subsection 4 sets parameters of how long a general and subcontractor should have to wait for retainage. This is what Dick Anderson talked about. It seems that from the time the work is completed until the time payment is made it just keeps growing and growing. It creates a cash flow problem for all concerned. In this bill we have tried to put some time frames in for the release of retainage. The time frames would be 45 days after the governmental agency or the owner receives the billing statement or the date the certificate of occupancy is given. Subsection 5 limits the retainage the a general contractor can apply to a subcontractor. When a state project is done, the state in their contract with the general contractor, states that they will retain 10% of the first 50% of the job. With a \$10 million construction project, the general contractor will do 20% and the subcontractors will do 80%. As the work progresses and each payment is made, when the \$5 million mark is reached \$500,000 of that money is put into a retainage account. The remainder will be paid to the contractor and the subcontractors. If the job is going fine, no more money will be withheld as a retainage. So full payment will be made from that time on. The general contractor then tells the subcontractor that he is going to withhold 10% on the entire project. From the general contractor's perspective, when the \$10 million is paid



only 5% is withheld but in essence he is holding an additional 5% from all the subcontractors. We do not think that is fair. Thank you for the opportunity to go through these amendments. There are a number of subcontractors here that would like to speak also.

**Zack Pallister, President, Big Sky Plumbing and Heating, Helena.** He gave his testimony and handed in the written copy **EXHIBIT (bus21a03)**.

**Joel Wolfe, President, Polar Electric.** I support the bill with the amendments. Retainage is a tough item for all concerned. A good example would be this: you borrow an item, pay with a \$20 bill and instead of receiving change at that moment, the clerk decided to keep it for six months. Six months later you finally get your money. I don't think anyone here would appreciate it and that is the boat we are in all the time. Whether a state or private job, we are still waiting for the payment of our monies. We would appreciate it if you all would support the bill with amendments.

**Jim Wolfe, Project Manager, Polar Electric.** Many of the problems that we see with general contractors and owners of retainage is that of our profit margin. It sometimes cuts into the overall amount of the cost of the job. So if 10% is being retained from your cash flow and there is only 8% profit in there, you are at a negative 2% at the start. It makes it tough for a general and a subcontractor to manage their cash flow. I stand for the passage of this bill with the amendments.

**Robert Pierson, Pierson Painting.** We have been in business 27 years in Montana. We employ on average 10 people annually. At any given time we have on average \$50,000 in retainage and that is year around. That is money we could use during the winter time when it is slow. We support **SB 240** with the American Subcontractors Assoc. of MT's amendment.

**Tim Crow, Big Sky Sprinklers & Landscaping.** We are in a little different situation in our business. During the winter there is little to no work. It seems ridiculous that we should have any receivables on the books. The retainages are always on the books. We do our work and feel that we should be paid when the job is finished. We need that money to invest in capital improvements. We try to keep some employees through the winter to keep continuity in our business. I support this bill with the amendments.

**Jenny Kalchbrenner, Merit Mechanical Services, Helena.** She gave her testimony and handed in the written statement **EXHIBIT (bus21a04)**.

**Opponents' Testimony:**

**Jim Whaley, Chief, Design Bureau, Administration.** As the bill is currently drafted, we need to oppose the bill for two reasons. One, there is currently a mechanism in place that the state does not require schools or local government to follow the statute 18-1-301 MCA. That allows for contractors to submit either a bond or a CD as security deposit and all interest earned off of those CD's go directly to the contractor. It is used generally on larger projects and it is not normally used on small projects. The current statute applies to all construction projects and this bill will create a tremendous burden on us to figure out what the retainage is, what the interest rates are for a given period of time as retainage increases throughout the course of the project and tapers off. It would be an accounting nightmare. The current mechanism in place is simple and workable. I would propose that the language be extended to local government. If we could work out some amendments, we might be able to support the bill.

**Tim Reardon, Chief Counsel, Legal Services, Department of Transportation.** We are not really an opponent of this legislation, but I would like to present informational testimony. I visited with Mr. Foster before the hearing and there are some questions we have, but I believe we are going to be able to solve most of those that relate to the accounting issues. I would like the committee to consider a provision to allow the enforcement of the action in district court in which the contractor resides. We have a lot of contractors from out of state. If the bill could be amended to allow the bill to read: unless otherwise agreed in writing between the parties, then you could be in the district in which the contractor resides. That would address our concerns.

***{Tape : 1; Side : B; Approx. Time Counter : 19.1}***

**Questions from Committee Members and Responses:**

**SEN. BEA MCCARTHY** asked **Mr. Anderson** that under current law, who earns the interest on the money that is put up as collateral.

**Mr. Anderson** replied the person who puts up the bond. If I have to take a CD out on a job, I have to use my own money and in that way the owner does not have to hold a retainer because their name

and mine are on the CD. I wouldn't have a problem with the subcontractors at that time if each wanted to bring in their portion. **SEN. MCCARTHY** said that the contractor is putting up the total bond and the subcontractors do not put up anything. Would your group like the subcontractors to put up a portion of the bond and then split the interest? **Mr. Anderson** said that if he had a \$100,000 job and if he has to retain \$10,000 and the state retain \$10,000, and if the subcontractor wants the earned interest, he would have to put his share in and the general would not retain.

**SEN. MIKE SPRAGUE** asked **Mr. Anderson** a question. **Mr. Anderson** said that the committee should be careful not to confuse a bond with retainage. When a contract is bonded there is no interest. It is just a performance maintenance material bond. The state lets you add to a CD. If you start at zero and they retain \$100,000 of your first pay request; you have to show you have taken out a CD for \$100,000. When it is \$200,000, you have to bring in another CD. Ideally, it would be best if the state would pay us interest. But the retainage is sometimes held forever. **SEN. SPRAGUE** asked if a percentage was built into the price. **Mr. Anderson** said that they were the low bidder on the capital restoration. It is a \$14 million job. They don't have the cash in order to do the project and they will have to borrow money as they go along. He would love to say they had 10% on this job. He felt they were in on that job at 5½%. Between the subcontractors and himself, they are going to help cash flow the state on the job.

**SEN. VICKI COCCHIARELLA** asked **Mr. Carl Schweitzer** if this bill deals with retainage and not with deposits. **Mr. Schweitzer** said that when a general contractor gets a contract with the state they have one of two options. They have the option of either putting up a CD which is equal to the amount of retainage that would be withheld from them, or they could have retainage withheld. He felt that **Mr. Anderson** was saying that some contractors do put up that collateral. However, this bill deals with retainage when it is withheld. That is what they are trying to deal with here. In the other circumstance, when the collateral is put up, the general contractor still does withhold retainage from the subcontractors though none is withheld from him because he has put up the security.

**SEN. MCCARTHY** asked **Mr. Whaley** about his objection. **Mr. Whaley** wanted an amendment on the bond or the CD and in which section was desirable. **Mr. Whaley** said they would like to eliminate the bulk of the bill as it stands. They would add language to 10-18-103 that would require the contractor to put up a CD or a bond

(interest bond). This would be held as security on the retainage. We release the retainage to the contractor.

**SEN. MCCARTHY** asked **Mr. Foster** what he thought about the previous statements. **Mr. Foster** felt that he needed to visit with more people but his initial reaction was positive. Concerning the amendments from the subcontractors, he felt that he had not had enough time to digest them completely since he had received them a few minutes before the hearing was started. He hoped that all would be able to sit down and come up with an agreement.

*{Tape : 1; Side : B; Approx. Time Counter : 29.7}*

**SEN. JOHN HERTEL** asked **Mr. Foster** if he felt that it was possible that a unified amendment could come out of all this. **Mr. Foster** replied "yes," he was hopeful about this.

**SEN. DALE BERRY** asked **Mr. Foster** what the statute allowed on the retainage and is there anything in the statute that puts a limit on the time for repayment. **Mr. Foster** said that was a good question and he didn't have an answer at this time. **Mr. Whaley** responded that the retainage is held until the work is complete. Generally 10% is withheld on the first part of the project and at the end of the project it is approximately 5%. At the end of the project, the architect and owner walk through the building and identify deficiencies. If there are no deficiencies, the retainage is released. But if not, it is held back until all is settled and finished.

**SEN. BERRY** then asked that assuming the job is complete and there is nothing left to be done, then should the money be released quickly? **Mr. Whaley** said that is correct.

**SEN. MCCARTHY** asked **Mr. Anderson** to respond to the above. **Mr. Anderson** said that it is not just the retention at the end of the job. They have been retaining the whole time. You may have a two year job and they have held money from you for two years and if the retainage is not paid promptly after the job is finished you don't have your money and you don't even get the interest. Right now I have three jobs. One is \$8000; one is \$7000; one is \$9000. But it has been over 1½ years and they have not had a chance yet to final everything out for the general contractor. They have said recently they might get to them this spring. If he could even get the interest, he would feel he was getting something out of it.

*{Tape : 1; Side : B; Approx. Time Counter : 36.1}*

**SEN. COCCHIARELLA** asked **Mr. Foster** if it was possible that the coffers were empty and it was just an excuse not to pay these retainage fees back. **Mr. Foster** said that might be a possibility. If the money comes out of the contractor's pocket, then there should be money there. But if it is money that the owner was going to pay but holds back, then his people are saying that money should be put into an interest bearing account.

**SEN. SPRAGUE** asked **Mr. Whaley** if disputes were part of the problem and the contracts were not being paid on time. **Mr. Whaley** said that there is always a contingency amount of money withheld. Projects usually are not perfectly laid out and finished. If an unforeseen condition arises, the contractor is due additional money and therefore a change order is made up. If an amount can be agreed upon, a change order is processed and it is treated as part of the contract. If there is a legitimate dispute, this has to be resolved one way or the other before any payment can be made.

**SEN. HERTEL** asked **Mr. Reardon** about the kind of paper work that would be involved in his office that this bill would create. **Mr. Reardon** said, in talking with his financial wizards, there is a means to segregate these accounts. There will be more paper work, but it is a doable thing. With the State Funds, they are invested by the Board of Investments, so there may be a fiscal consideration here. The interest may be going into the General Fund. He was not sure about this though. **SEN. HERTEL** asked how the money was invested now at this time. **Mr. Reardon** said the Board of Investments handles the money.

*{Tape : 1; Side : B; Approx. Time Counter : 45.5}*

**Closing by Sponsor:**

**SEN. GRIMES** closed. Thank you for the great hearing. I hope you can see the necessity of this bill. As you heard, Montana contractors help the public cash flow the job with money that is rightfully theirs. I am suggesting that the contractors and subcontractors get together and work out the amendments and get the amendments back to the committee.

**ADJOURNMENT**

Adjournment: 10:40 A.M.

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SEN. JOHN HERTEL, Chairman

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MARY GAY WELLS, Secretary

JH/MGW

**EXHIBIT** (bus21aad)